

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: Victoria Kanrek
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from: John Sweeney
(Branch Chief, CC:INTL:B08)

subject: Providing Notification to a Withholding Agent When a Beneficial Owner Claiming a Withholding Exemption for Effectively Connected Income Fails to File Tax Returns

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether, under Treas. Reg. § 1.1441-7(b)(1), the Service can notify a withholding agent that a beneficial owner's claim of exemption from withholding on payments of income effectively connected with the conduct of a United States trade or business ("effectively connected income") is incorrect when the Service determines that the beneficial owner has not filed U.S. income tax returns for several years for which the beneficial owner has claimed the exemption.

CONCLUSION

The Service can provide such notification based on its determination that the beneficial owner's claim of exemption is incorrect due to the beneficial owner's failure to file income tax returns reporting income for which it has claimed such exemption. To the extent that the withholding agent fails to withhold on payments made to the beneficial owner after 30 calendar days from the date it receives such notification, the withholding agent may be liable under section 1461 for any deficiency in the amount withheld.

FACTS

The withholding agent (“WA”) filed Forms 1042-S with the Service showing a claimed exemption for withholding on payments of effectively connected income. During an examination, WA provided the Service with the Forms W-8ECI, “Certificate of Foreign Person’s Claim That Income is Effectively Connected With the Conduct of a Trade or Business in the United States,” that it had on file and relied on to support the withholding exemption for each of these payments.

The Service determined that one of the beneficial owners (“BO”) that furnished a Form W-8ECI to WA for the years at issue, and thus was not withheld upon, did not file a U.S. income tax return for any of those years (or for any subsequent years to date). BO continues to claim an exemption from withholding on effectively connected income. Based on this determination, the examiner proposes to send a notification instructing WA that it cannot rely on BO’s claim of exemption for effectively connected income. You have requested advice as to whether the Service has authority to provide such notification under the regulations pertaining to sections 1441 and 1442.

ANALYSIS

Sections 1441 and 1442 generally require a withholding agent to withhold 30 percent of any payment of U.S. source fixed or determinable, annual, or periodical income made to a foreign person that is an amount subject to withholding. See Treas. Reg. § 1.1441-2(a). However, section 1441(c)(1) states that no withholding is required for any item of income which is effectively connected with the conduct of a U.S. trade or business and which is included in the gross income of the recipient under section 871(b)(2) (providing for graduated rates of tax for effectively connected income of nonresident alien individuals).¹

Section 1.1441-4(a)(2), which addresses the withholding agent’s reliance on a claim of exemption by a beneficial owner for effectively connected income, states:

Absent actual knowledge or reason to know otherwise, a withholding agent may rely on a claim of exemption [for effectively connected income] if, prior to the payment to the foreign person, the withholding agent can reliably associate the payment with a Form W-8 upon which it can rely to treat the payment as made to a foreign beneficial owner [A] withholding certificate is valid only if, in addition to other applicable requirements, it includes the taxpayer identifying number of the person whose name is on the Form W-8 and represents, under penalties of perjury, that the amounts for which the certificate is furnished are

¹ Section 1442, by cross-reference to section 1441, provides an exception for withholding on effectively connected income that is included in the gross income of the recipient under section 882(a)(2) (providing for graduated rates of tax for effectively connected income of foreign corporations). Because the provisions of section 1441 and its accompanying regulations generally apply for purposes of section 1442, we will just refer to those provisions for purposes of this memorandum. See section 1442; Treas. Reg. § 1.1442-1.

effectively connected with the conduct of a trade or business in the United States and is includable in the beneficial owner's gross income for the taxable year. In the absence of a reliable claim that the income is effectively connected with the conduct of a trade or business in the United States, the income is presumed not to be effectively connected

The general provisions relating to withholding agents state, in relevant part:

A withholding agent must withhold . . . if it has actual knowledge or reason to know that a claim of U.S. status or of a reduced rate of withholding under section 1441, 1442, or 1443 is unreliable or incorrect. . . . For purposes of the regulations under sections 1441, 1442, of 1443, a withholding agent may rely on information or certifications contained in, or associated with, a withholding certificate or other documentation furnished by or for a beneficial owner or payee unless the withholding agent has actual knowledge or reason to know that the information or certifications are incorrect or unreliable **A withholding agent that has received notification by the Internal Revenue Service (IRS) that a claim of U.S. status or of a reduced rate is incorrect has actual knowledge beginning on the date that is 30 calendar days after the date the notice is received.**

Treas. Reg. § 1.1441-7(b)(1) (emphasis added).

You have asked whether the "30-day provision" in Treas. Reg. § 1.1441-7(b)(1) (in bold above) limits the Service's authority to notify a withholding agent that it cannot rely on a claim of exemption to when the Service has sufficient facts to prove that the information provided by the beneficial owner on the Form W-8ECI is incorrect. For the following reasons, we do not interpret the 30-day provision as providing such a limitation.

A withholding agent that receives a valid Form W-8ECI must still withhold if it has actual knowledge or reason to know that the claim of exemption for effectively connected income is incorrect. Thus, a withholding agent's ability to rely on a beneficial owner's claim that a payment is effectively connected income is not limited to the information provided by the beneficial owner on a Form W-8ECI. The "claim" being made by the beneficial owner is that it is entitled to an exemption from withholding on effectively connected income that is included in its gross income for the taxable year. See section 1441(c)(1).

Here, BO has claimed in prior years that it is entitled to an exemption from withholding for effectively connected income by providing the Form W-8ECI to WA. In making this claim, BO certified, under penalties of perjury, that "[t]he amounts for which this certification is provided are effectively connected with the conduct of a trade or business in the United States and are includible in [its] gross income (or the beneficial owner's gross income) for the taxable year." The Form W-8ECI also included a "Note" at the top

of the Form that states, “Persons submitting this form must file an annual U.S. income tax return to report income claimed to be effectively connected with a U.S. trade or business.” Thus, we interpret the claim made by BO on its Form W-8ECI as including a representation that it will timely file a U.S income tax return to include the effectively connected income in its gross income for the years that WA relied on such Form and thus did not withhold.

As BO has made this claim of exemption for effectively connected income and has failed to file tax returns including such amounts in gross income, we conclude that the Service can determine the claim to be “incorrect” and provide direct notification to WA under Treas. Reg. § 1.1441-7(b)(1) that it cannot rely on BO’s claim of exemption. WA will not be able to rely on BO’s claim of exemption beginning on the date that is 30 calendar days after the date that WA receives this notification. To the extent that WA continues to rely on BO’s claim after this date and does not withhold, it may be liable under section 1461 for any tax due on payments for which withholding applies. If BO files a U.S. income tax return for a year in which WA withholds pursuant to the notification received by the Service, it may claim a credit or refund (if applicable) for the amounts withheld at source. See sections 1462, 1464; Treas. Reg. § 301.6402-3(e).

We express no opinion as to whether the notification that the examiner proposes to send to the withholding agent raises confidentiality and/or disclosure of return information issues under § 6103, including the extent of information that may be provided to a withholding agent in a manner consistent with the requirements of § 6103.

CASE DEVELOPMENT, HAZARDS, AND OTHER CONSIDERATIONS

We have not addressed the circumstances under which a withholding agent that has received notification from the Service can once again rely on a beneficial owner’s claim of exemption from withholding on effectively connected income. We can provide further assistance on this issue upon request.

Please call Subin Seth at (202) 317-5003 if you have any further questions.